3 1761 07488431 3

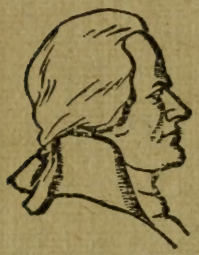
EcC
M6896

EcC
M6896

[Modern business Talks]

CASHING IN ON FOREIGN TRADE

The average exporter or importer does not need to be an authority on foreign exchange, but it is vital that he know enough to secure expert advice and service when he needs it.



MODERN BUSINESS
TALK No. 33
(WITH VOLUME 17)

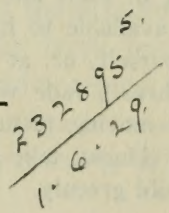
ALEXANDER HAMILTON INSTITUTE
NEW YORK

R.A. 33

FH 201

Cashing In on Foreign Trade

This Talk, to be read in connection with Volume 17, forms part of READING ASSIGNMENT 33



ALEXANDER HAMILTON INSTITUTE
NEW YORK

Copyright, 1919 by Alexander Hamilton Institute
Copyrighted in Great Britain in 1919
All Rights Reserved

READING ASSIGNMENT

The current Reading Assignment consists of three parts: (1) this Talk, (2) Chapters I to X of the MODERN BUSINESS Text on "Domestic and Foreign Exchange," and (3) Lecture 17.

The way to remember, as Dean Johnson pointed out in the first volume of the Text, is to look thru the words of description at the picture behind. Don't let the words entangle you; get the picture. If the writer has not painted it for you, perhaps because the mere catalog of facts and principles had exhausted all the space available to him, stop long enough to paint it for yourself, or, at the worst, snapshoot it. Words and phrases fade with time. But illustrations, incidents—moving pictures—by reason of their realness and vividness, take deeper roots in the memory and grow old greenly.

Cashing In On Foreign Trade

> Nothing is more sensitive to restrictive conditions than international credit—it must ebb and flow freely, or go elsewhere.—Page 134, Chapter VIII, Volume 17 of the MODERN BUSINESS Text.

Many a man who has sold his own notes in the market and has at some time or other paid a bill or been paid in "exchange on New York" is nevertheless all up in the air when it comes to getting his money thru foreign exchange.

He is like a certain Western manufacturer of agricultural implements who had his first experience of this nature quite a number of years ago, in the normal days long before the war. This manufacturer had at first felt disinclined to "go far from home", but at length set aside his prejudice and accepted an order from an English jobber. The amount was £210 and the terms of sale provided for a thirty days' sight draft on London.

Armed with the invoice, bill of lading, insurance certificate and draft, the manufacturer sought his banker, in some perplexity.

"I want you to tell me", he said, "how to turn this draft into money in the quickest and least expensive way. I have full assurance as to the buyer's reliability, but this is my first experience in the export

business and you will have to show me where to step."

The banker smiled. "I have often wondered", he said, "just why you stayed out of it, particularly in view of the fact that American manufacturers of agricultural implements are already selling extensively in South America, China, India and Russia."

"Well, as you know, the home demand has always kept us jumping", answered the manufacturer. "We have thought of exporting. But we are already working up to the limit of our capital and feel that we can't afford to tie up much of it in foreign shipments for five, six or nine months at a time."

"If that is the only reason", replied the banker, "I am sorry you did not mention it before, because the financial part is not at all the serious problem you think it. In fact, I see no difficulty whatever there. Your credit here is good, your product is excellent. It is all a question of working up a trade among foreign customers of similarly good credit standing. In that event, there is no reason why you should not get your bills discounted and have the amount credited to you almost as soon as the goods leave the factory."

"Is it possible?" exclaimed the manufacturer. "I had no idea it was as easy as that."

Your Money in Three or Four Days

"Take this shipment, for instance", continued the banker. "Here is the invoice and thru bill of lading showing that the railroad has accepted the goods for re-shipment at New York for London. Here is the insurance certificate to show that the shipment is duly

insured. These are the 'documents', as they are called. Now all we have to do is to attach the documents to the draft and send it to New York to be sold. Our correspondent bank in that city will attend to the matter for us and in three or four days' time I shall doubtless be able to notify you that the proceeds of the transaction have been received and deposited to your account.

"We make a small charge for the service", went on the banker. "The discount also will be slight. The reason for that is that you are supplying the New York market with something for which there is always a demand, namely, 'exchange on London', which merely means the right to collect money in that city. If it were not possible to buy this exchange, debtors in New York would have to ship gold to settle their accounts abroad.

"Instead of doing that, however, these importers or other debtors owing London, or Paris, or Calcutta, simply buy drafts in the open market—your draft, for instance—just as you buy exchange on New York to settle your bill for steel in Pennsylvania, or lumber in some other state. In this way huge trade balances between countries are adjusted by the simple, inexpensive device of slips of paper.

"The drafts are used as money and go from hand to hand as needed, perhaps four or five times before maturity, canceling a debt at each transfer. The New York bank which buys your draft will either sell it in the market there, if it wants the money at once, or send it over for collection in thirty days if

it prefers to save the discount. The London correspondent bank will do likewise.

Discount About 3 Per Cent

"Today", he continued, consulting the morning paper, "demand exchange on London is quoted at $4.86. Yours is a thirty-day bill, which means that interest for thirty-three days (three days' grace) will be deducted from the face of the draft on present sale. The bank of England discount rate today is quoted at 4 per cent, but the private rate is usually 1 per cent lower; hence your bill would be discounted at about 3 per cent. There are some minor charges, including the profit of the New York bank, but these are not likely to exceed one cent per pound sterling. But no doubt you have anticipated these charges and included them in your price."

That was years ago. At the outbreak of the present war, the Western manufacturer was selling to every quarter of the globe. He found advantages in doing so he had not previously suspected. His large factory had no dull months now. When the buying season stopped in North America it started up in South America. The wide distribution of demand had taken up all the slack in his business and stabilized it.

Happily, also, the education of his banker had kept pace with his own. He was now able to transact all his foreign exchange business with this near-by bank instead of sending the draft on to New York for discount and waiting several days for his money.

These various matters which were touched upon

in the manufacturer's conversation with the banker are explained in detail in the chapters on "Rate of Exchange", "Bills of Exchange", and "A Day in an Exchange Box", to be found in the current reading assignment of the Text. The last named is particularly illuminating.

Foreign Exchange Licenses in War

With the outbreak of the war the situation changed for the manufacturer. Much of his trade has been temporarily lost. He has had to substitute other lines. Part of his plant was, in fact, working on munitions orders. For such foreign business as he does he has been obliged, since February, 1918, to take out an export license, and also in order to discount his drafts obtain a registration certificate from the foreign exchange department of the Federal Reserve Bank in his district and explain each transaction. This is to prevent any aid being extended to the enemy.

Bills on London are Cheap

Nor is there any difficulty at this time in buying London exchange. Quite the reverse. London exchange before the war was never far from $4.86. During the war it was $4.75. It has gone down because England is buying far more than she can sell, or than is coming back to her in interest and dividends, and also because she became a heavy borrower. Whatever partial adjustments might be made by gold shipment are not taking place because of the high rates of marine and war risk insurance. This discount on

pound sterling will doubtless last as long as do the abnormal conditions.

Gains for Dollar Exchange

The conditions favor another tendency that is to our advantage, a tendency that has been gaining momentum for some years—the movement for direct or dollar exchange between this and other countries, that is, without the intermediation of London bankers. Instead of selling a draft on London, the American manufacturer can, in certain cases, just as readily sell a draft on customers or their banks in any of several countries, particularly in South America—Chile, for instance, which has now formally adopted the dollar for settlements in trade between the two countries. The exchange will be figured from dollars to pesos or from pesos to dollars, that is to say, instead of from dollars to pounds and then from pounds to pesos. The transaction is not made thru London, and the London bankers make no commission on it. It is cheaper exchange.

In many cases foreign buyers, instead of remitting thru exchange on London, open credits in American banks for American exporters to draw against. The bank then accepts the latter's drafts and makes them immediately discountable in the local market.

More Dollar Credits in Importing

Credits in American banks are, however, issued far more often in import transactions than in export; in such cases by American houses for the foreign

exporters to draw against. Ordinarily, as explained in the chapter on "Foreign Exchange and Imports", in the accompanying Text, the majority of letters of credit have been hitherto issued on London, but the European War and the Federal Reserve Act have now given dollar credits a much improved position. These foreign drafts in dollar exchange made on American banks and accepted by them become, if the banks are members of the Federal Reserve System, eligible for rediscount at the Reserve banks.

The import credits used to be issued in London. The American importer got his own local bank to establish a credit with a London bank and so notified the exporter in China, India or South America by means of a commercial letter of credit. The exporter then drew on the London bank, and the London bank, in turn, collected from the importer's American bank. The exact steps are described in the Text.

Now the importer in many instances, particularly in South American business, may have the exporter draw directly on his American bank.

Getting the Right Bank

At all times, the exporter and the importer must depend largely on their bankers for sound advice and proper service. It is well to take note of the fact that all bank service is not the same—there are differences that may make or break a profit.

A manufacturer located at a large interior point recently filled a $40,000 order for shipment to one of the neutral countries of Europe. When he took his

draft to the bank, the latter declined to discount it on the ostensible ground that it was not organized to transact foreign exchange. It offered to handle the draft for collection, and advance 75 per cent of it on loan.

The manufacturer objected. After some inquiries he decided that the reason his bank would not accommodate him was, not because it was not "organized" to buy foreign bills, but because it actually did not know how.

"Your banker has had experience only in selling credit", a friend told him. "He evidently thinks that in buying your bill he would be selling the use of actual money. But he could have sold your draft next day in New York, just as you will have to do. He miscalculated his risk. The worst that could happen would be that the consignee would refuse to accept the shipment, or would have failed. In that case the goods would be disposed of, possibly at once, thru some machinery house designated by the foreign bank last buying the draft. The risk, therefore, would be no more than the difference between the bill and the emergency selling price of the goods, and there would be several chances for profit."

Dealt Thru Foreign Bankers

Another case shows more complication. A well-known export commission house in the West sold $500,000 worth of automobile trucks to a South American jobber. It took the documents to a local bank to arrange to have its drafts discounted so that

it could pay the truck manufacturer. The bank looked the house up and saw that it was ordinarily entitled to a credit of $200,000. Accordingly, it offered to advance $150,000 on the order while it was being collected.

Immediately the export people were incensed.

"I won't deal any further with American banks", declared the manager. "This is the last time. I have cabled the Milan bankers with whom we have done business before. What do they do? They look us up, but they also look up the other end of the transaction—they look up the South American house. And they find it good for a million, any time. So they cable back they will advance 85 or 90 per cent on our $500,000 order for trucks, which, of course, are under their control all the time until full settlement is made."

The exporter was far wrong in his deductions. Several banks in this country are already extending accommodation of the kind he said could not be obtained on this side of the Atlantic. The situation, moreover, is improving in this respect, not only from year to year, but even from month to month. The incident is cited because it shows what some exporters and some banks actually do. The business man must at all times be on his guard against "snap" judgments.

Stage Set for Big Expansion in Foreign Trade

The reader who has previously digested the MODERN BUSINESS Texts on "Foreign Trade and Shipping" and "Banking" will not have failed to conclude that our export trade after the war is going to be

very different from what it was before it. The war business will fall away, but the factory facilities will still be there and will have to be operated to earn dividends. As the home market cannot possibly absorb the output, the finger points strongly to foreign trade. For many reasons, which have been detailed in previous texts, this overseas trade, a long time growing and now abnormally swollen, is in for a genuine revival after the war. We have been warned against too great optimism, but it is well to get the state of mind of our genial competitors in the foreign markets.

"I have talked with many manufacturers on the other side", says Secretary Redfield, in one of his public addresses, "and if there is one thing they dread more than another as regards the future of their own businesses, it is that America shall wake up to her privilege and her power."

One by one the impediments to this larger and freer participation in foreign commerce are being removed from our path. The war is giving us a huge merchant marine. Thanks to the new Federal Reserve Act, American banks are able to extend branches into foreign countries, and are doing it. American investment is following, and this is vital, because without foreign investment there can be no large and permanent foreign trade. The first American discount company has been organized on the lines of the big London discount companies to deal in bankers' and trade acceptances arising in foreign commerce. Lastly, American manufacturers will not very much longer have to face individually and alone the organ-

ized, combined, subsidized competition of foreign nations. The legislation that will permit them to combine and cooperate in foreign trade is on its way thru Congress.

Call for Trained Men to Help

But development takes men as well as money. Where are the men coming from who are going to add to the output, find and manage the markets and finance the expansion? There are several classes out of which they will have to come.

First, the manufacturers who will have a surplus to export. Some of them are already being educated by their work in munitions. They are thinking hard about trade outlets now that the war is over. For many months now the big banks doing a foreign business have been hearing from them with questions about exporting and foreign exchange.

Then there are the young men of, say, 25 to 35 years, department heads, many of them, in big businesses. They are outgrowing their jobs, we will say, and there isn't anything bigger right on the spot to offer them. Here is the vista they get in this new direction — American trade expanding, American export houses developing, new ones rising, export departments being added to countless American manufacturing concerns, foreign branches and agencies being established abroad, millions and millions of American capital investments being made there.

Some of these men are beginning right now to paint pictures of themselves as export managers, as

trade specialists in banks and commission houses, as agents and foreign salesmen, opening up connections in European, Asiatic, African and South American capitals, crossing every sea, traversing every continent. It is not going to be so lonesome for the American abroad as it has been. He is going to have plenty of company from home even in the depths of China and Siberia.

It is a prospect that pleases. And these young fellows are already at work picking up the rudiments of foreign trade and exchange, not to mention a foreign language or two.

New Careers for Bigger Executives

The most striking development is likely to be the draft that is going to be made upon the men "higher up" for service in the cause. Take a typical case. He is a merchant or manufacturer of special experience, a man somewhat skilled in finance, a director in his local bank. He has traveled in Central and South America and has observed the peoples there at close quarters, in their homes and offices. He speaks their language, after a fashion. This man has "arrived", as the French say; he is successful. The last thing he thinks of is starting off on a new career.

And yet that is just what the new call means. Read what the officer of one of the big export banks, recently organized, and operating in South America, says:

"We are already serving some of the larger concerns. We do not find it profitable, however, to do

everything in a day. We find a great lack of experience along this special line, because it requires American bankers to do this work, and America has not many of them. It would appear that it is our job to take men who know mercantile lines and who have had some experience in banking, in financing their own organizations or otherwise, and develop them into bankers, provided they know the language and have some experience and knowledge of the people of these countries."

Other large banking houses, too, are engaged in developing our foreign commerce. Still others will follow. The need of all is the same—men.

It is a Time for Caution

The time, in short, is past for preaching the opportunities of foreign trade. The actual rush will soon be on. Our present duty is to warn and caution. In many ways, we are still children at the export game. It is true in spite of the wonderful success of a few of our big export houses. It is predicted by those who should know that too many of our manufacturers are in line for some very costly experience unless they lay hold now of every scrap of information that has a bearing on their problems.

Fortunately, there is no lack of knowledge if they will go after it. The current Text of your own Course, for instance, especially when reinforced by the preceding volumes on "Foreign Trade and Shipping" and "Banking", should give ample protection against mistakes of oversight and precipitancy.

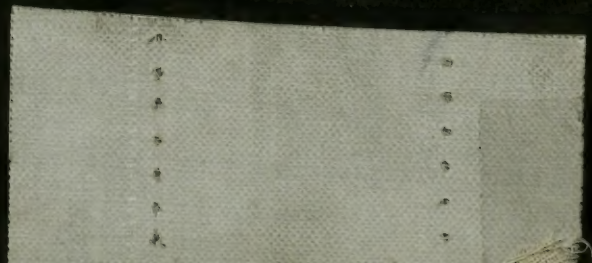
The subject of domestic exchange has been passed over in this Talk. It is commonly understood and is, besides, clearly and entertainingly described, with abundant examples, in the Text.

Two Developments in Domestic Exchange

One thing may be added, and it is an important addition. Domestic exchange has hitherto been effected largely by drafts on New York. New York exchange, as is often said, is the "business man's money." Two important factors are now affecting it. One of them is the clearing of bank checks thru the Federal Reserve Banks. This will more and more tend to give the bank check a national circulation and so do away with some portion of the necessity for New York exchange.

The other change is the developing use of Reserve Bank checks or drafts. A merchant in Chicago, for instance, wishing to pay a manufacturer in New Jersey, might procure thru his bank a draft from the local Reserve Bank on the Reserve Bank of New York, if he found the cost of doing this were less than by other means, or wished to save his correspondent the costs of collection, and transmit it to his Eastern creditor who would then collect thru his own bank. This development has taken place only in the last few months. Just how far it will go with relation to New York exchange and to national check clearing must be left for time to decide.

NO
26



UTL AT DOWNSVIEW
D RANGE BAY SHLF POS ITEM C
39 11 11 04 13 012 5